

**Department of Health and Human Services**

**OFFICE OF  
INSPECTOR GENERAL**

**REVIEW OF MEDICARE  
CONTRACTOR'S PENSION  
SEGMENTATION, BLUE CROSS AND  
BLUE SHIELD OF NORTH DAKOTA**



**JUNE GIBBS BROWN  
INSPECTOR GENERAL**

**FEBRUARY 2001  
A-07-99-02560**



## DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General  
Office of Audit Services

Region VII  
601 East 12th Street  
Room 284A  
Kansas City, Missouri 64106

CIN: A-07-99-02560

February 1, 2001

Mr. Allen Aaberg  
Assistant Vice President  
Blue Cross and Blue Shield of North Dakota  
4510 13<sup>th</sup> Avenue S.W.  
Fargo, North Dakota 58121-0001

Dear Mr. Aaberg,

This report provides you with the results of an Office of Inspector General (OIG), Office of Audit Services (OAS) review titled *Review of Medicare Contractor's Pension Segmentation, Blue Cross and Blue Shield of North Dakota*. The purpose of our review was to evaluate Blue Cross and Blue Shield of North Dakota's (North Dakota) compliance with pension segmentation requirements of its Medicare contract.

Our review showed that North Dakota understated its January 1, 1992 Medicare segment assets by \$180,634. The understatement occurred because North Dakota did not implement our recommendations from a prior audit report. However, North Dakota's update of the Medicare segment assets from January 1, 1992 to January 1, 1998 overstated segment assets by \$1,529,366. The overstatement primarily occurred because North Dakota did not make correct transfer adjustments.

We recommend that North Dakota decrease the January 1, 1998 assets of the Medicare segment by \$1,348,732 (\$1,529,366 less \$180,634).

North Dakota concurred with our findings and recommendation. Their response to our draft audit report is included in its entirety as Appendix B.

## INTRODUCTION

### BACKGROUND

North Dakota has administered Medicare Parts A and B under cost reimbursement contracts since the start of the Medicare program. The contracts, the Federal Acquisition Regulations (FAR), which superseded the Federal Procurement Regulations (FPR), and the Cost Accounting Standards (CAS) contain reimbursement principles for cost reimbursement contracts.

Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. These payments represented allowable pension costs under the FPR and/or the FAR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

The CAS 412 regulates the determination and measurement of the components of pension costs. It also regulates the assignment of pension costs to appropriate accounting periods. The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

The Health Care Financing Administration (HCFA) incorporated segmentation requirements into Medicare contracts starting with Fiscal Year 1988. The contractual language specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment.

North Dakota's contracts required (1) computing the Medicare segment's actuarial liability, (2) determining the ratio of Medicare segment's actuarial liability to the total plan actuarial liability (asset fraction), (3) allocation a portion of total pension assets as of 1986 based on the above ratio, (4) updating Medicare pension assets annually, and (5) assessing if Medicare's pension costs should be separately calculated.

The Medicare contracts identify a Medicare segment as:

*any organization component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare agreement/contract, in which:*

*The majority of the salary dollars is allocated to the Medicare agreement/contract; or*

*Less than a majority of the salary dollars is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract.*

The contracts also provide for separate identification of the pension assets of the Medicare segment. The identification involves the allocation of assets to the Medicare segment as of the first pension plan year after December 31, 1985 in which the salary criterion was met. The allocation was to use the ratio of the actuarial liabilities of the Medicare segment to the actuarial liabilities of the total plan, as of the later of the first day of the first plan year after December 31, 1980, or the first day of the first pension plan year following the date such Medicare segment existed.

Our previous segmentation review (CIN: A-08-94-00739) addressed the computation of the asset fraction, the identification of the segment's assets as of January 1, 1986, and the update of the segment's assets to January 1, 1992.

In reports provided for our current review, North Dakota identified total pension assets of \$40,527,946 and Medicare segment assets of \$4,115,474 as of January 1, 1998. North Dakota also concluded that separate valuations for the Medicare segment were required.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

We made our examination in accordance with generally accepted government auditing standards. Our objective was to determine North Dakota's compliance with the pension segmentation requirements of its Medicare contract. Achieving the objective did not require a review of North Dakota's internal control structure. The audit addressed North Dakota's update of its Medicare segment pension assets for the review period covering January 1, 1992 to January 1, 1998.

We performed this review in conjunction with our audits of unfunded pension costs (CIN: A-07-00-00116), and pension costs claimed for Medicare reimbursement (CIN: A-07-00-00117). The information obtained and reviewed during those audits was also used in performing this review.

In performing the review, we used information provided by North Dakota's prior and current consulting actuarial firms. The information included liabilities, normal costs contributions, expenses, and earnings. We reviewed North Dakota's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, we updated the Medicare segment assets to January 1, 1998. The HCFA pension actuarial staff reviewed our methodology and calculations.

We performed site work at North Dakota's corporate offices in Fargo, North Dakota during August 1999. Subsequently, we performed audit work in our Jefferson City, Missouri office.

## **FINDINGS AND RECOMMENDATIONS**

North Dakota's update of Medicare segment assets overstated the segment assets by \$1,348,732 as of January 1, 1998. This overstatement occurred because North Dakota: (1) did not implement the recommendations contained in our previous report (\$180,634 understated), (2) made incorrect transfer adjustments (\$1,048,384 overstated), (3) assigned excess contributions to the Medicare segment (\$401,159 overstated), (4) incorrectly assigned benefit payments (\$352,935 understated), and (5) incorrectly allocated investment earnings and expenses (\$273,112 understated).

### **Prior Audit Recommendations**

We determined that North Dakota's calculations understated the January 1, 1992 Medicare segment assets by \$180,634. The understatement occurred because North Dakota did not implement the recommendation contained in our previous segmentation report (CIN: A-07-93-00711). Not only did North Dakota not implement our recommendation, they reverted from a

revised update of Medicare segment assets to a prior update that we deemed unacceptable. During our current review, North Dakota acknowledged that they had concurred with the finding and recommendation from our prior report. However, North Dakota's prior and current consulting actuaries had not implemented the report recommendation in North Dakota's calculations.

The following schedule summarizes the details of the calculations.

	North Dakota	OIG	Variance
January 1, 1992 Medicare Segment assets	\$1,835,963	\$2,016,597	<u>(\$180,634)</u>

### **Participants and Transfers**

In the update of pension assets, North Dakota misidentified Medicare segment participants. North Dakota incorrectly included participants in non-Medicare cost centers and incorrectly excluded participants in Medicare segment cost centers. Since the identification of participants was incorrect, transfers (representing the movement in and out of the segment each year) in the updates were also incorrect.

In accordance with the revised CAS, codified at CFR 9904.413-50(c)(8), "If assets and liabilities are transferred, the amount of assets transferred shall be equal to the actuarial accrued liabilities, determined using the accrued benefit cost method (ABCM), transferred." The revised CAS became effective to North Dakota with their plan year commencing on January 1, 1996. Therefore, the transfer adjustments computed for the end of plan year 1996 should have been based on the participants' actuarial liability determined under the ABCM.

In comparison, North Dakota's and our computations of transfer amounts were as follows:

Net Transfer Adjustments To The Medicare Segment

<u>YEAR</u>	<u>OIG</u>	<u>NORTH DAKOTA</u>	<u>VARIANCE</u>
1992	(\$203)	\$673,672	(\$673,875)
1993	14,587	220,500	(205,913)
1994	57,002	147,905	(90,903)
1995	(6,031)	(131,896)	125,865
1996	34,985	110,053	(75,068)
1997	57,108	185,598	(128,490)
Total	<u>\$157,448</u>	<u>\$1,205,832</u>	<u>(\$1,048,384)</u>

We corrected the identification of the segment participants and transfer amounts in updating the Medicare segment pension assets. We also corrected the 1996 and 1997 accrued actuarial liabilities transferred using the ABCM. Our corrections to the transfer amount decreased the Medicare segment assets by \$1,048,384.

### **Pension Contributions And Prepayment Credits**

North Dakota's update methodology did not equitably assign pension contributions to the Medicare segment. As a result, North Dakota overstated Medicare segment assets by \$401,159. The overstatement occurred primarily because North Dakota assigned contributions to the segment equal to the segment's computed pension costs.

North Dakota assigned a portion of the total company pension contributions to the Medicare segment based on its computation of the segment's separately calculated pension costs. Our changes to the asset base changed the computation of the segment's pension cost as well as the assignment of the contributions.

Additionally, for years 1994 through 1997, North Dakota's assigned contributions exceeded the required funding of the CAS pension cost. According to CAS 9904.412-50(c)(1), amounts funded in excess of pension costs (or prepayments) shall be carried forward with interest to fund future CAS pension costs. We considered these excess contributions in our computations and made prepayment adjustments to fund the CAS pension costs of the Medicare segment.

Using the pension costs as calculated by the HCFA Office of the Actuary (CIN: A-0-00-00117), we assigned an equitable portion of the total company contributions to the Medicare segment based on the required funding. See Appendix A. Our calculations decreased Medicare segment assets by \$401,159.

### **Benefit Payments**

Due to incorrect identification of the Medicare segment participants, North Dakota's update of segment assets did not properly identify benefit payments to retirees that were segment participants. We identified the actual benefits paid to the retirees from the Medicare segment and assigned these costs to the Medicare segment. This resulted in a net reduction of \$352,935 in the Medicare segment assets. A comparison of North Dakota's and our computed benefit amounts are shown on the following schedule.

Benefit Payments To Medicare Segment Retirees

<u>YEAR</u>	<u>NORTH DAKOTA</u>	<u>OIG</u>	<u>VARIANCE</u>
1992	\$630,867	\$905,817	(\$274,950)
1993	0	0	0
1994	0	0	0
1995	765,966	761,687	4,279
1996	1,207,968	1,253,168	(45,200)
1997	<u>130,593</u>	<u>167,657</u>	<u>(37,064)</u>
Total	<u><u>\$2,735,394</u></u>	<u><u>\$3,088,329</u></u>	<u><u>(\$352,935)</u></u>

### Earnings and Expenses

North Dakota's update methodology allocated investment earnings and expenses based on a ratio of segment assets to total company assets. Because North Dakota's asset amounts were incorrect, it understated the segment's earnings and expenses for each year of the update. Except for correcting asset amounts, as previously described, we used North Dakota's allocation methodologies in our update and increased the Medicare segment assets by \$273,112.

We recommend that North Dakota decrease Medicare segment pension assets by \$1,348,732. The decrease resulted from: (1) implementing our prior report recommendation (\$180,634 increase), (2) adjusting for participants that moved in and out of the Medicare segment (\$1,048,384 decrease), (3) assigning pension contributions equitably to the Medicare segment (\$401,159 decrease), (4) adjusting benefit payments (\$352,935 decrease), and (5) revising earnings and expenses (\$273,112 increase).

**Recommendation:**

We recommend that North Dakota:

- Decrease the Medicare segment pension assets by \$1,348,732 as of January 1, 1998.

**Auditee Response**

North Dakota concurred with our findings and recommendation. Their response to our draft audit report is included in its entirety as Appendix B.

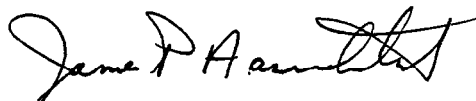
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**INSTRUCTIONS FOR AUDITEE RESPONSE**

Final determinations as to actions to be taken on all matters reported will be made by the HHS action official identified below. We request that you respond to the recommendation in this report within 30 days from the date of this report to the HHS action official, presenting any comments or additional information that you believe may have a bearing on final determination.

In accordance with the principles of the Freedom of Information Act (Public Law 90-23), OIG, OAS, reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise.  
(See 45 CFR Part 5).

Sincerely,



James P. Aasmundstad  
Regional Inspector General for  
Audit Services, Region VII

Enclosures

HHS Action Official:

Ms. Mary K. Smith  
Regional Administrator, Region VIII  
Health Care Financing Administration  
1961 Stout Street  
Denver, Colorado 90294-3538



BLUE CROSS BLUE SHIELD OF NORTH DAKOTA

STATEMENT OF MEDICARE PENSION ASSETS

January 1, 1992 To January 1, 1998

Description	Total Company	Other Segment	Medicare Segment
Assets as of January 1, 1992	<u>1/</u> \$22,952,929	\$20,936,332	\$2,016,597
Prepayment Transfers	<u>2/</u> \$0	\$0	\$0
Contributions	<u>3/</u> 0	0	0
Earnings	<u>4/</u> 888,357	810,308	78,049
Benefit Payments	<u>5/</u> (5,668,392)	(4,762,575)	(905,817)
Expenses	<u>6/</u> (104,711)	(95,511)	(9,200)
Participant Transfers	<u>7/</u> 0	203	(203)
Assets as of January 1, 1993	\$18,068,183	\$16,888,757	\$1,179,426
Prepayment Transfers	\$0	\$0	\$0
Contributions	1,800,249	1,570,014	230,235
Earnings	1,857,378	1,736,135	121,243
Benefit Payments	(879,878)	(879,878)	0
Expenses	(132,113)	(123,489)	(8,624)
Participant Transfers	0	(14,587)	14,587
Assets as of January 1, 1994	\$20,713,819	\$19,176,952	\$1,536,867
Prepayment Transfers	\$0	\$(59,810)	\$59,810
Contributions	2,763,495	2,569,228	194,267
Earnings	137,232	126,654	10,578
Benefit Payments	(930,615)	(930,615)	0
Expenses	(107,784)	(99,476)	(8,308)
Participant Transfers	0	(57,002)	57,002
Assets as of January 1, 1995	\$22,576,147	\$20,725,931	\$1,850,216

BLUE CROSS BLUE SHIELD OF NORTH DAKOTA  
STATEMENT OF MEDICARE PENSION ASSETS

January 1, 1992 To January 1, 1998

Description	Total Company	Other Segment	Medicare Segment
Prepayment Transfers	\$0	\$(186,604)	\$186,604
Contributions	2,927,058	2,898,650	28,408
Earnings	5,938,217	5,402,471	535,746
Benefit Payments	(2,850,767)	(2,089,080)	(761,687)
Expenses	(114,257)	(103,949)	(10,308)
Participant Transfers	<u>0</u>	<u>6,031</u>	<u>(6,031)</u>
Assets as of January 1, 1996	\$28,476,398	\$26,653,450	\$1,822,948

Prepayment Transfers	\$0	\$(744,580)	\$744,580
Contributions	3,241,839	3,237,752	4,087
Earnings	4,538,571	4,211,139	327,432
Benefit Payments	(5,293,530)	(4,040,362)	(1,253,168)
Expenses	(143,798)	(133,424)	(10,374)
Participant Transfers	<u>0</u>	<u>(34,985)</u>	<u>34,985</u>
Assets as of January 1, 1997	\$30,819,480	\$29,148,990	\$1,670,490

Prepayment Transfers	\$0	\$(731,638)	\$731,638
Contributions	5,051,262	5,051,262	0
Earnings	6,595,338	6,104,148	491,190
Benefit Payments	(1,722,934)	(1,555,277)	(167,657)
Expenses	(215,200)	(199,173)	(16,027)
Participant Transfers	<u>0</u>	<u>(57,108)</u>	<u>57,108</u>
<b>Assets as of January 1, 1998</b>	<b>\$40,527,946</b>	<b>\$37,761,204</b>	<b>\$2,766,742</b>
<b>Per North Dakota</b>	<u><b>8/ \$40,527,946</b></u>	<u><b>\$36,412,472</b></u>	<u><b>\$4,115,474</b></u>
<b>Asset Variance</b>	<u><b>9/ \$0</b></u>	<u><b>\$1,348,732</b></u>	<u><b>(\$1,348,732)</b></u>

BLUE CROSS BLUE SHIELD OF NORTH DAKOTA  
STATEMENT OF MEDICARE PENSION ASSETS

January 1, 1992 To January 1, 1998

**FOOTNOTES**

- 1/ We calculated the January 1, 1992 Medicare segment assets during our previous segmentation review. The amounts shown for the other segment represent the difference between the total company and the Medicare segment.
- 2/ We obtained total contribution amounts from IRS Form 5500 reports. North Dakota did not make contributions to the pension plan trust fund for the year 1992 because the plan was overfunded.
- 3/ North Dakota provided earnings amounts and we verified them to IRS Form 5500 reports. We allocated earnings to the Medicare segment based on the ratio of beginning-of-year (BOY) market values of Medicare assets to the BOY market values of total company assets. North Dakota used this methodology as well.
- 4/ North Dakota provided benefit payment amounts and we verified them to IRS Form 5500 reports. We used actual benefit payments for Medicare segment retirees.
- 5/ North Dakota provided administrative expense amounts and we verified them to IRS Form 5500 reports. We allocated administrative expenses to the Medicare segment on the ratio of BOY market values of Medicare assets to the BOY market values of total assets. North Dakota used this methodology as well.
- 6/ A prepayment credit is created when the contributions made to the pension trust fund exceed the CAS pension cost. The prepayment remains unassigned and accumulates interest in the pension trust fund until needed to fund future CAS pension costs. We assigned the prepayment in proportion to the CAS pension costs.
- 7/ We identified participant transfers between segments by comparing annual participant valuation listings provided by North Dakota. The listings contained the actuarial liability of each participant. Our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. We calculated the funding level as the assets divided by the liabilities. If the funding level ratio was greater than one, we transferred assets equal to the participant's liability. North Dakota used this methodology as well.
- 8/ We obtained the total assets as of January 1, 1998 from North Dakota's update of assets provided by its actuary.

BLUE CROSS BLUE SHIELD OF NORTH DAKOTA  
STATEMENT OF MEDICARE PENSION ASSETS

January 1, 1992 To January 1, 1998

9/ The asset variance represents the difference between the OIG calculation of assets as of January 1, 1998 and the assets calculated by North Dakota's actuary.